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TAGS: EFIN EAID ECPS ECON EAGR ETRD VM
SUBJECT: INTEREST RATES GO UP, DONG GOES DOWN

REF: Hanoi 634 (Economic Data Sends HCMC Into a Panic)

¶1. (U) Summary. The State Bank of Vietnam raised several key interest rates by 2.0 percentage points, in an effort to rein in inflation and slow lending growth, the latter of which is running at more than 60 percent higher than a year ago. Even with these increases, however, deposit and lending rates are capped at levels that do not keep with inflation, which is running at around 25 percent. The SBV also announced a one-off 2 percent devaluation of the fixing rate around which the Vietnamese dong can trade, but left the trading band for the currency unchanged at plus/minus 1 percent of the official fixing rate. Analysts were universally supportive of the interest rate hike, although many expect further increases. Views were mixed on the one-off devaluation, but market reaction has been relatively subdued. End Summary.

¶2. (U) On June 10, the State Bank of Vietnam (SBV) raised several interest rates by 2.0 percentage points, bringing the base interest rate to 14 percent, the discount rate to 13 percent and the re-financing rate to 15 percent. (The base interest rate is not used by the SBV to provide liquidity, but instead to determine maximum lending rates in the country.) Lending rates are capped at 1.5 times the base rate, so the new official cap for lending rates now will be 21 percent, up from 18 percent previously (reftel). The SBV also announced that any additional "management" or "commitment" fees being charged by lenders would no longer be allowed. For the past several months, various bank fees has been widely used to increase the past rate cap of 18 percent to an effective rate of 21 percent - 22 percent for all borrowers except large State-owned enterprises (SOEs) that continued to be able to borrow at the official rate or less from State-owned commercial banks (SOCBs).

¶3. (U) The SBV's changes in policy interest rates have already prompted banks to offer higher deposit rates, which should help attract more deposits into the banking system and improve liquidity. Local banks quickly put signs in their windows advertising deposit rates anywhere between 17 and 19 percent. At the same time, the resulting increase in lending rates (also now capped at 21 percent) is intended to reduce demand for credit. The SBV is targeting credit growth of 30 percent in 2008, although the recent figures show credit growth up more than 60 percent compared to the same period last year. The IMF sees room for more rate hikes, and the SBV has not ruled it out.

¶4. (U) At the same time, the SBV also adjusted the inter-bank dollar exchange rate from 16,139 to 16,461 dongs. This adjustment is essentially a 2 percent one-off devaluation of the local currency. The trading band, however, is still at one percent, despite earlier comments by the PM that it would be widened to two percent. While this devaluation moves the official rate slightly closer to black market values (which have been hovering around 17,500 - 18,000 dongs

per dollar), some analysts initially criticized it for sending a possible signal that the GVN could not defend its peg at the previous rate. Reaction by local investors has been muted so far, indicating that perhaps the move did not have adverse effects on confidence.

COMMENT

¶5. (SBU) While it is positive to see the SBV taking action to calm markets and to move closer to market-based interest and exchange rates rather than operate on administrative mandates, further increases in the interest rate structure are likely to be needed to slow credit growth to within the government's target. The small devaluation may have been the bone the government threw to businesses facing higher borrowing and input costs - although it will only help the exporters. Of more help to the exporters would be significant monetary tightening to prevent the real (inflation-adjusted) value of the dong from appreciating significantly. End comment.

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